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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 801

WALTER G. HOUGLAND, JR., PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the Circuit Court of Appeals (R. 396–398) is reported in 166 F. 2d 815. The memorandum findings of fact and opinion of the Tax Court of the United States (R. 374–384) are not reported.

JURISDICTION

The judgment of the Circuit Court of Appeals (R. 396) was entered on March 22, 1948. The petition for a writ of certiorari was filed on May 12, 1948. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the court below erred in affirming the decision of the Tax Court holding that all the income derived from a so-called partnership, composed of the petitioner, his mother, and his wife, was taxable to petitioner.

STATUTE AND REGULATIONS INVOLVED

These are set forth in the Appendix, *infra*, pp. 9–11.

STATEMENT

This case involves a deficiency in individual income tax asserted against the taxpayer, Walter G. Hougland, Jr., in the sum of $29,930.04 for the taxable year 1940. (R. 385.)

The facts pertaining to the issue herein, as found by the Tax Court (R. 375–380), and affirmed by the court below (R. 397), may be summarized as follows:

The taxpayer, with the financial assistance of his father by whom he was employed, purchased a towboat for $158,000, and, under the name "Hougland's," engaged profitably in river transportation. In August, 1939, about two years after his purchase of the towboat, the taxpayer sold a one-half interest therein to his mother. She delivered to him her promissory note in the face value of one-half of the cost of the towboat, less an agreed depreciation, and assumed joint liability with her son on three promissory notes, aggregating $30,000, which he had delivered to his

father to cover the cash borrowed. The liability of his mother to the taxpayer, however, was to be discharged out of her share of the profits of the business. (R. 397.)

On January 1, 1940, the taxpayer and his mother "sold" a one-third interest in "Hougland's" to the wife of the taxpayer under virtually the same arrangements which had been made at the time the taxpayer sold a half interest to his mother. Neither the mother nor the wife had funds of their own at the time of the respective transfers to them; nor was there any change in the management or control of the business by the taxpayer after these transfers were made. Neither the mother nor the wife contributed any vital services to the operation of the business. (R. 397.)

Upon the basis of the foregoing facts the Tax Court, affirming the Commissioner's determination (R. 19–27), held that the alleged family partnership was not controlling for federal income-tax purposes and that, therefore, the Commissioner properly included all the income therefrom in the taxpayer's gross income for the taxable year 1940 (R. 382–383). The Circuit Court of Appeals affirmed (R. 396–398).

ARGUMENT

This is another case involving the taxation, for federal income-tax purposes, of the income of a so-called family partnership. The case

was properly decided by the Tax Court and the court below. No question is presented which requires further review. The courts below properly applied the standards enunciated by this Court in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, and the decision below is in accord, as well, with innumerable decisions of the Circuit Courts of Appeals and the Tax Court.[1]

In the *Tower* and *Lusthaus* cases, *supra,* this Court held that family partnerships erected upon gifts or unreal assignments of business capital, though effective under state law, are without federal income-tax significance if the arrangement produces no substantial change in the creation of the business income but merely a reallocation of it within the donor's or assignor's family. Whether the claimed partnership, so tested, has reality presents a question of fact for the Tax

[1] Other decisions also in accord in which the taxpayers' petitions for writs of certiorari have been denied by this Court during the present term are *Fletcher* v. *Commissioner,* 164 F. 2d 182 (C. C. A. 2d), certiorari denied, March 15, 1948, No. 566, this term; *Eisenberg* v. *Commissioner,* 161 F. 2d 506 (C. C. A. 3d), certiorari denied, 322 U. S. 767; *Wilson* v. *Commissioner,* 161 F. 2d 556 (C. C. A. 4th), certiorari denied, 332 U. S. 769; *Scherf* v. *Commissioner,* 161 F. 2d 495 (C. C. A. 5th), certiorari denied, 332 U. S. 810; *Belcher* v. *Commissioner,* 162 F. 2d 974 (C. C. A. 5th), certiorari denied, 332 U. S. 824; pending on petition for a writ of certiorari is *Quon* v. *Commissioner,* 165 F. 2d 215 (C. C. A. 9th), No. 791, this term.

Court whose conclusion is final if supported by substantial evidence. Unless the donee or assignee "invests capital originating with her or substantially contributes to the control and management of the business, or otherwise performs vital additional services, or does all of these things" (*Commissioner* v. *Tower, supra,* p. 290), the Tax Court is justified in concluding that the donee or transferee is not a real partner for tax purposes.

These principles are applicable here. The taxpayer's mother acquired her interest in the partnership by purchase from the taxpayer, and the wife in turn likewise acquired her interest by the purchase of one-half thereof from each the taxpayer and his mother.[2] Each paid for her interest with notes payable from the profits of the business, just as the wife purchased from her taxpayer-husband one-half of her partnership interest with notes payable from the profits of the business in the *Lusthaus* case, and as the father and mother purchased their respective partnership interests from their taxpayer-son and his wife in *Singletary* v. *Commissioner,* 155

[2] *Durwood* v. *Commissioner*, 159 F. 2d 400 (C. C. A. 8th)—relied upon by the taxpayer (Br. 18) for the contention that his wife's acquisition of her one-sixth interest from his mother was a *bona fide* transfer—is not to the contrary. There the respective partnership interests of the taxpayer's son, wife and daughter did not come from the taxpayer but from others—his brothers—whereas here the interest of the taxpayer's mother and wife admittedly came from him.

F. 2d 207 (C. C. A. 5th).[3] The passage of mere titular ownership of portions of the taxpayer's business capital to his mother and wife shifted two-thirds of his partnership interest to them nominally and in harmony with legal form. This, however, did not change the economic realities—the taxpayer nevertheless continued, as before, to produce the respective shares of the business income ascribed to them, and in so far as they were concerned the partnership was "merely superficial, and did not result in changing the husband's [taxpayer's] economic interest in the business." *Lusthaus* v. *Commissioner, supra,* p. 297.

Further support for the conclusion of the court below is furnished by the fact that the mother's and the wife's admission into the partnership as partners is not shown to have served any business purpose. (R. 376–377.) *Commissioner* v. *Tower, supra,* p. 289. Moreover, the principles laid down in the *Tower* and *Lusthaus* cases are equally applicable to situations where members of the family other than the wife, such as the fathers, mothers, sons or daughters become partners. *Singletary* v. *Commissioner, supra; Wilson* v. *Commissioner,* 161 F. 2d 556 (C. C. A. 4th), certiorari denied, 332 U. S. 769; *DeKorse* v. *Commissioner,* 5 T. C.

[3] *Singletary* v. *Commissioner*, 155 F. 2d 207 (C. C. A. 5th), is an example of a ruling that even though a partnership already exists, it does not follow that those who contributed neither capital nor services became *bona fide* partners thereof.

94, affirmed *per curiam,* 158 F. 2d 801 (C. C. A. 6th); *Mauldin* v. *Commissioner,* 155 F. 2d 666 (C. C. A. 4th); *Hash* v. *Commissioner,* 152 F. 2d 722 (C. C. A. 4th), certiorari denied, 328 U. S. 838, rehearing denied, 328 U. S. 879.

As is plain from its opinion, the Tax Court properly addressed itself to the critical question of "who earned the [business] income," which, it stated (R. 382–383), is determined by ascertaining whether the parties really intended to carry on the business as partners. *Commissioner* v. *Tower, supra,* pp. 286–287. It found, upon the evidence, that neither the mother nor the wife was a real partner for tax purposes (R. 383); neither had any funds of her own at the time of the transfer to her to pay for her partnership interest other than from the prospective earnings of the business, or partnership income to apply to her individual notes for the acquisition of her interest (R. 376, 377–378, 383); neither contributed any vital or substantial services to the operation of the business, or capital originating with herself (R. 376, 383); the taxpayer admittedly continued to manage, operate, and control the business after such acquisitions just as he had before (R. 376, 377, 383); and that substantially all the partnership income was used to pay the liabilities incurred for the acquisition of the equipment of the partnership business (R. 375, 377–378, 383). Thus no new capital, services, control, or management was added.

CONCLUSION

The decision of the court below is correct. It turns upon and is supported by the facts, and presents no question calling for further review. There is no conflict of decisions. The petition should therefore be denied.

Respectfully submitted.

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MAY 1948.

APPENDIX

INTERNAL REVENUE CODE

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual a * * * tax * * *.

* * * * *

(26 U. S. C. 1940 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity. (26 U. S. C. 1940 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183 (b). (26 U. S. C. 1940 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and Partner.*—The term "partnership" includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term "partner" includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1940 ed., Sec. 3797.)

TREASURY REGULATIONS 103, PROMULGATED UNDER THE INTERNAL REVENUE CODE

SEC. 19.22 (a)–1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains,

profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined * * *.

* * * * *

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